

**MINUTES
of the
SECOND MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**July 22-23, 2015
State Capitol, Room 322
Santa Fe**

The second meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for the 2015 interim was called to order by Senator Carlos R. Cisneros, chair, on Wednesday, July 22, 2015, at 10:08 a.m. in Room 322 of the State Capitol in Santa Fe.

Present

Sen. Carlos R. Cisneros, Chair
Sen. Ted Barela
Sen. Sue Wilson Beffort
Rep. David M. Gallegos
Rep. Tim D. Lewis
Rep. Antonio Maestas
Rep. Rod Montoya
Sen. George K. Munoz (7/23)
Sen. Clemente Sanchez (7/22)
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Carl Trujillo
Rep. Jim R. Trujillo
Sen. Peter Wirth

Designees

Sen. William F. Burt
Rep. Randal S. Crowder
Rep. Conrad James
Rep. Bill McCamley
Sen. Nancy Rodriguez (7/23)

Absent

Rep. Jason C. Harper, Vice Chair
Sen. Mark Moores
Rep. Debbie A. Rodella

Rep. David E. Adkins
Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Sen. Lee S. Cotter
Rep. Brian Egolf
Rep. Miguel P. Garcia
Rep. Stephanie Garcia Richard
Rep. Bealquin Bill Gomez
Sen. Stuart Ingle
Sen. Gay G. Kernan
Rep. Stephanie Maez

Rep. Javier Martinez
Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend
Sen. Pat Woods

(Attendance dates are noted for members who did not attend the entire meeting.)

Staff

Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Rebecca Griego, Records Officer, LCS
Tessa Ryan, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Wednesday, July 22

State Investment Council (SIC) Annual Update

Steven K. Moise, state investment officer, SIC, and Vince Smith, deputy state investment officer, SIC, made a presentation, summarized as follows, on: the state permanent funds' fiscal year (FY) 2015 and the SIC's general investment strategy; the effects on fund health of certain contributions and distributions; and the private equity investment program. Charles Wollman, communications director, SIC, who was in the audience, contributed periodically to the presentation.

FY 2015 investment performance; investment strategy. Compared with previous fiscal years' ends, the SIC-managed funds' combined balance reached a record high at the end of FY 2015 of nearly \$20.6 billion. The Land Grant Permanent Fund's (LGPF's) balance was \$14.8 billion, the Severance Tax Permanent Fund's (STPF's) balance was \$4.7 billion, the Tobacco Settlement Permanent Fund's balance was \$216.4 million and the Water Trust Fund's balance was \$43.3 million. The investments in that period yielded a 3.6% return — short of the target 7.5%, but factored into a three-year average of 10.6%.

The SIC continues studying its asset allocation and shifting to a more diversified portfolio. The portfolio includes more income-producing real assets and, as allowed by a 2014 constitutional amendment, more international investments. At 18% of the SIC's portfolio,

international investments represent a smaller portion of the portfolio as compared with most of the SIC's peers' funds.

Contributions to and distributions from the funds. At about \$849.3 million, distributions for FY 2016 from the LGPF and the STPF also surpass previous records. The land grant beneficiaries' distributions totaled almost \$656 million. The severance tax distribution to the general fund is nearly \$194 million.

The SIC strives to make possible the provision to future generations of fund benefits in equal or greater proportion to current levels. Investment returns, inflows and distribution rates most affect the amounts of annual distribution from the two major funds.

The SIC projects that FY 2017 distributions from the two funds will decrease slightly to \$845 million but that distributions will then rise. The dip is largely due to the future expiration of a provision that increased the LGPF distribution rate.

The STPF is in relatively poor, albeit improving, health. Of the \$486 million in severance tax revenue collected in FY 2015, only about \$97.00 was transferred to the fund's corpus. Since 15 years ago, and when adjusted for inflation, the STPF has lost value. STPF distribution rate increases have hampered the fund's growth, as illustrated by the LGPF's increasing share of the SIC-managed funds' combined balance. However, an enacted legislative measure from the last regular session (House Bill (HB) 236) to gradually decrease STPF bonding capacity will increase annual inflows to the fund and relax swings in its annual inflow levels. Yet even with that measure, there is only about a 25% chance that the fund will maintain its economic value 50 years from now. To increase those odds to 50%, the state would have to increase inflows to the fund or the SIC would have to make, and be successful in, riskier investments.

The private equity investment program. New Mexico law allows investment of up to 9% of the STPF in venture-based private equity. Believing it prudent, the SIC has set a 5% target for investment of money in this program, whose secondary mission is job creation. Prior to 2004, the investments had a negative return. Returns then began to improve significantly. Since 2004, returns have averaged 4.7%.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Inflows to the STPF. The changes enacted through HB 236 will, among other things, reduce volatility in the levels of inflow to the STPF and stimulate the fund's growth through the power of compounding interest. Some members articulated the economic and job-creation value of spending money that would otherwise be deposited into the fund. Mr. Moise responded that the SIC refrains from influencing policy on matters such as the proportion of STPF distribution to inflow, but is willing to suggest other possible sources of revenue for capital projects. He also

said that increasing inflows to the fund is probably the most effective way to improve the chance that the fund will maintain its value 50 years from now. A member commented that, when the state was required under the *Zuni* lawsuit to increase capital spending, policymakers had to choose between increasing taxes or increasing severance tax bonding capacity. At that time, there was little political will to increase taxes.

The private equity investment program and international investments. Mr. Moise explained that the SIC has not exercised its power to invest the maximum allowed into the private equity investment program because the SIC is wary of jeopardizing that program's rate of return; the SIC strives to balance the goal of job creation with responsible investment. The SIC believes that its ability to make more international investments will prove beneficial.

Projected STPF value. The SIC's 50-year model for real economic value reflects variables that include changes in the population, changes in the number of taxpayers and the potential for periods of recession. Mr. Moise responded that, in addition to incorporating projected economic information into its model, the SIC applies that information to its asset allocation decisions. A member remarked that the SIC should consider as part of its inter-generational equity goal relieving the future financial burden on the aging population.

SIC staff. The SIC has 25 of its 32 authorized full-time positions filled and plans to fill some of its vacancies. The SIC employs consultants at the state and national levels to manage its investing needs. The broad range of its investments requires specialized expertise that those consultants provide. Those consultants, the SIC staff and SIC members provide many levels of investment review.

The Economic Impact of the Arts and Cultural Industries

Veronica Gonzales, secretary of cultural affairs, and Jeff Mitchell, director, Bureau of Business and Economic Research (BBER), University of New Mexico, delivered a presentation on a recent study, the first of its kind, that examined the contributions of the arts and culture industries to the state's economy and that identified challenges to and opportunities for developing what is termed the "creative economy". The study was commissioned by the Cultural Affairs Department (CAD) and conducted by the BBER.

CAD overview. Secretary Gonzales named several of her staff who were in the audience and highlighted her department's mission, programs and achievements. The CAD focuses on cultural preservation and education to enhance quality of life and the economy. It operates eight museums, eight historic sites and programs in: arts services; history and archaeology preservation; library services; and program support. Through the CAD's programming, vast numbers of residents and tourists have been enriched by and educated in New Mexico art and culture.

Economic impact study. Secretary Gonzales cited some findings of and the department's response to the BBER study. New Mexico's art and culture industries contribute billions of

dollars to the state's economy and support 76,780, or nearly one in 10, of its jobs. Further, these industries provide the intangible benefit of educating youths and preparing them for the work force.

Mr. Mitchell briefly introduced himself and the study. As an economist, he works with state and local agencies to offer a perspective on economic development, but not to advocate for any particular policy. The purpose of the study, he said, was to understand the direct and indirect impacts of the art and culture industries, which are rapidly growing worldwide.

Mr. Mitchell summarized the study's findings, including the creative economy's role in economic development, its scale, its employment types and geographic distribution, its potential growth areas and its fiscal impacts. A location's cultural profile, which influences entrepreneurship and the work force, has increasingly become a factor in its economic strength; locations with strong creative economies are growing the most. In New Mexico, the number of jobs associated with the creative economy, when defined to encompass a wide swath of areas, exceeds that in construction and manufacturing. The proportion of jobs in arts and culture to all other jobs is highest in the state's rural areas, namely in McKinley, Rio Arriba and Taos counties. The number of New Mexico's arts and culture jobs exceeds the national average by 3%. Comparatively, the state has a high concentration of its arts and culture jobs in cultural goods production and cultural goods distribution, but not in intellectual property. Of those three categories, intellectual property boasts the highest average wages. Lastly, the study found that spending on arts and culture at the local level runs a deficit, largely because of the high cost of libraries, but at the state level, there is a net return.

Future action. Secretary Gonzales characterized as critical windows of opportunity some action items that the CAD wishes to pursue. They include: 1) building cohesion within the arts and culture sector; 2) developing a web-based platform for networking among those associated with the sector; 3) increasing support for the New Mexico Arts grants program; 4) increasing cultural heritage tourism; 5) implementing a cultural collaborative initiative; 6) developing cross-agency partnerships with the tourism, public education and economic development departments; and 7) establishing and strengthening partnerships between Santa Fe and Albuquerque. Secretary Gonzales remarked that the creative economy, in which New Mexico is a leader, stands to change and grow. She asked for the committee's support for investing in the creative economy.

Mr. Mitchell stressed that New Mexico could more fully exploit its resources and characteristics to develop economically, through arts and culture initiatives, and to create long-lasting jobs. Moreover, he said, the world is changing in ways that make arts and culture an area ripe for growth, particularly in the subcategory of intellectual property. Ways to encourage that growth include: 1) establishing public-private partnerships around networking and business support; 2) emphasizing community-level capacity building; 3) emphasizing education; and 4) incorporating creative industries in economic policy. Catalysts, strategically targeted support, coordination, communication and engagement are key factors in those initiatives.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Fiscal impact. Mr. Mitchell said that the model used to measure the creative economy's impact was based on static input-output measures. A member commented on the usefulness of employing a dynamic model to show more fully a given initiative's economic effects.

Interagency collaboration. Secretary Gonzales indicated that the CAD and the Economic Development Department (EDD) will continue discussions about collaborating to develop the creative economy. A member suggested that recent large-scale appropriations to implement the Local Economic Development Act be used in part for that development. Another member suggested that the secretaries of agencies best positioned to influence the creative economy's growth discuss ways to reduce bureaucratic barriers to business creation and expansion. Another member proposed that those key agencies work with business incubators to develop a plan for supporting businesses in the creative economy. Mr. Mitchell agreed that business incubators are well-positioned to stoke the creative economy by connecting entrepreneurs to marketing, financing and communication resources. Secretary Gonzales noted that the CAD has worked with the WESST business incubator in the creative economy context.

EDD and the creative economy. Wade Jackson, general counsel, EDD, who was in the audience, talked briefly about the cultural properties tax credit. A bill introduced in the last regular session would have increased the incentive for people to improve their cultural properties. After a member expressed interest in having the committee consider that bill for endorsement, Senator Cisneros requested staff to ask Jon Barela, secretary of economic development, to present the legislation at a future meeting.

Expressions of support for arts and culture. Several members expressed appreciation that arts and culture are increasingly recognized as significant drivers of economic development, not simply a pastime for the well-to-do. Some members highlighted arts and cultural institutions and events in their districts, praising their contributions to the local economies and quality of life.

New Mexico Small Business Development Center (SBDC): Providing Economic Development Assistance to Small Businesses

Russell Wyrick, state director, SBDC, gave an overview of his program as follows. The SBDC, the state's only nationally accredited business assistance program, operates through 19 regional centers, seven procurement technical assistance program centers and the International Business Accelerator in Santa Teresa. The SBDC receives funding from the state and from a federal Small Business Administration grant. Its procurement technical assistance program also receives money from the federal Defense Logistics Agency. Through one-on-one, no-cost training, the SBDC enables budding and existing entrepreneurs to establish and grow businesses. The SBDC actively reaches out to potential clients to offer its services. It connects its clients to advanced research tools to enhance their success.

Outcomes. The SBDC uses an economic impact verification system to measure its results. Since its inception in 1989, the program has helped clients create and retain nearly 27,000 jobs. It has helped clients start thousands of businesses, secure millions in federal prime- and sub-contract awards and secure millions in loans and equity.

Current return on investment and potential SBDC growth. The state currently spends \$4.4 million on the SBDC. This money leverages over \$1.1 million in federal grants and generates about \$9.5 million in tax revenue, or \$2.14 for every dollar invested in the program. Also for every dollar invested, \$5.40 flows into the state from federal contracts. The vast majority — 92% — of the International Business Accelerator's budget is derived from the SBDC.

The annual state investment in the SBDC has decreased by \$653,700 since FY 2009. To adjust to its reduced appropriations, the SBDC has laid off staff, reduced its rural outreach and cut back on staff professional development. The SBDC estimates that the decrease corresponds to an annual loss of almost \$1.4 million in state tax revenue. An increase in the state's current investment in the SBDC would improve the state's international trade, tax revenue and ability to promote business growth.

Questions and Discussion

On questioning, the committee and Mr. Wyrick addressed the following topic.

Services and job creation. The SBDC provides customized services to its clients. It identifies a client's needs and coaches the client through the process of business creation or growth. The SBDC's services include helping clients secure capital for infrastructure. Its efforts result in job creation in each of the state's 33 counties. Mr. Wyrick encouraged committee members to contact their local SBDCs if the centers can be of help. At a member's request, Mr. Wyrick agreed to share a database that lists the number of clients in each county with whom the SBDC has had contact.

Report of the State Auditor on Unspent Fund Balances

Timothy Keller, state auditor, and Ruby Ann M. Esquibel, government accountability officer, Office of the State Auditor (OSA), presented as follows on a report released by the OSA in March titled "Money on the Sidelines: Report on Unspent Fund Balances, Fiscal Year 2014".

Overview of the OSA. State Auditor Keller began by explaining that the OSA primarily audits or oversees the audits — which number over 900 — of the state and its political subdivisions. Most of those audits are conducted by contracted firms approved by the state auditor. The OSA also conducts some forensic audits and, to a limited degree, performance audits. It plays a role in regulating the accounting industry. To accomplish these major functions, the office is divided into several divisions headed by the state auditor, an elected official whose office is constitutionally created. An alternative set of audit rules, "agreed upon procedures", applies to small political subdivisions. That alternative allows for accountability at a lower financial cost. In general, the OSA has set out to: improve compliance among the

entities it oversees; financially and otherwise support entities that struggle to comply with the audit requirement; cause a reduction in the number of findings in audited entities' audits; and address chronic issues in those entities' accounting practices.

Special investigations. The OSA's Special Investigations Division curbs governmental fraud, waste and abuse. The OSA's fraud hotline helps the office detect fraudulent activity. Most fraud made known to the OSA is discovered through tips, including those routed through the hotline, and some fraud is made known through audits. State Auditor Keller spoke briefly about certain special investigations currently under way.

Government Accountability Office (GAO). To address waste and financial issues and to improve the performance of the state and local governments, the GAO examines audited financial statements of audited entities, including those entities' revenues and expenditures and compliance with the conditions of federal funding. With a focus on transparency, the GAO analyzes those entities' financial practices and the return on their investments.

New Mexico's financial health. State Auditor Keller explained some basic accounting terms to provide a basis for better understanding a report on New Mexico's financial health. A government audit is a process in which an auditor examines the financial statements of an entity to determine the degree, if any, of material misstatements. The auditor then issues an opinion. Opinions fall into one of four categories, from "unmodified" (best) to "disclaimed" (worst). An audit report might contain a finding, which is an indication of a deficiency or noncompliance.

According to the annual financial health report card issued by the OSA, New Mexico's financial health has recently improved. The number of "at-risk" entities, or those late in submitting an audit, has fallen. The OSA has been working directly with at-risk entities and with the Department of Finance and Administration (DFA) to help the entities complete their audits. Over 90% of all audited entities have clean audits. Among entities, there are over 2,000 findings, many of which are repeat findings. The OSA plans to address the most prevalent needs for corrective action by offering training. It also plans to resume the production of a finding report.

Fund balance report. Ms. Esquibel turned the committee's attention to the fund balance report. It evolved out of an interest in improving accountability and transparency in government and an awareness that the state is charged with satisfying great needs using limited resources. Data for the report came from the most current independently audited financial statements of state agencies. The OSA has made available on its web site a spreadsheet of the information contained in its report so that the public may access it and provide feedback. Although the report drew attention to the fact that the state has large financial reserves in its many funds, the OSA does not advocate that money in any fund be used for a purpose for which it is not intended, urges that the state maintain sufficient general fund reserves to cover budget shortfalls and recognizes that there are restrictions on the uses of money in the state's funds.

In its study, the OSA found that: 1) there is: \$4.2 billion in more than 700 funds designated for a specific purpose; \$473 million in restricted special revenue funds; \$462 million in water-related funds; \$338 million in debt-service funds; and \$30 million in assigned and unassigned general funds, or those with the fewest restrictions on spending; 2) funds overseen by the DFA, more than those of any other agency, have the highest aggregate balance; 3) the bulk of the money in funds whose use is restricted for special purposes is not concentrated in any one agency; 4) the Wastewater Facility Construction Loan Fund contains the most unspent money for water-related purposes; and 5) the Statewide Infrastructure Bond Fund contains the most unspent money for infrastructure. The report also lists, among others, balances in funds overseen by agencies that manage infrastructure projects. Much of that money is stalled for reasons that include: lack of required matching funds; funding insufficiency; project phasing; conflicting priorities or the lack of priority; and difficulty reaching project readiness.

State Auditor Keller summarized his impressions of and responses to the findings. He commented that the report paints a complex portrait of unspent money: for each fund, a different set of restrictions applies. He relayed his experience as a senator having secured capital outlay money to beautify a median in his district. The money has gone unspent because the city had a conflicting idea for the use of that space. Unlike that situation, capital money was put to productive use in Albuquerque's Paseo de Norte/I-25 project. To improve the productivity of money dedicated to capital outlay projects, the OSA has suggested the following: addressing the executive order restricting certain spending; exercising more discipline in appropriating money to projects; focusing on project implementation; and addressing the problems inherent in infrastructure financing and building. State Auditor Keller closed by saying that the report was intended to shine a light on the state's reserves and be a helpful source of information for, and stimulate dialogue among, policymakers.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Political subdivision audits. A member commented, and State Auditor Keller agreed, that entities need help with fixed-asset auditing. State Auditor Keller identified as key problems faced by entities in rural areas the scarcity of auditors, the rising costs of audits and the lack of access to modern technological resources. A member recommended that the OSA scrutinize school districts more since the state ends up liable for the districts' violations of federal provisions.

Fund balance report. State Auditor Keller said that in recent years, when maintaining solvency was a primary concern, the figure representing unspent infrastructure funds was probably lower than the current \$2.1 billion figure. When asked whether the high balances maintained in funds used by the Children, Youth and Families Department and the Public Education Department are average, as compared with those of other states, State Auditor Keller recommended directing that and related questions to the agencies or the Legislative Finance Committee (LFC). Some members pointed out reasons that maintaining reserves is appropriate

or advisable to maintain high bond ratings because of constitutional limitations and to avoid upsetting the entities whose use the money was intended for. Members requested that the OSA: 1) if producing the report in the future, and with the LFC's help, more saliently portray what money can and cannot be reasonably tapped; and 2) avoid presenting such a report in a way that may give the public the impression that more of the state's resources are available for spending than are actually available. State Auditor Keller responded that, going forward, the OSA will request more feedback from agencies and refine the report's content and presentation. A member requested an explanation of why "unassigned" fund balances, at almost \$771 million, are so high.

Reversions. A member observed that a lot of money for capital outlay gets stalled — i.e., avoids reversion — because of project reauthorizations. Some members pointed out that enacting laws requiring more automatic reversions of unused money might, in many but not all cases, be useful.

Capital infrastructure hurdles. Several members described capital outlay hurdles they had experienced. In some cases, money stalled because of restrictions imposed by the executive order; in other cases, projects were vetoed because they were not listed in the community's infrastructure capital improvement plan. State Auditor Keller remarked that the executive order imposes strict requirements. He advocated employing councils of governments to serve as fiscal agents to overcome the order's strictures. Several members commented, and State Auditor Keller agreed, that successful capital outlay projects require coordination among local authorities in a given region. A member expressed doubt that the executive order would withstand a court challenge and that it may represent an attempt to shrink government spending. A member requested from the OSA a report outlining common issues in capital outlay spending and recommended that the office interview local authorities in preparing the report. State Auditor Keller commented that, although the legislature has made water infrastructure projects a priority, it appears that multi-jurisdictional complexities, other red tape and project-cost underestimation have at times derailed those projects.

The committee recessed at 4:40 p.m.

Thursday, July 23

Approval of Minutes

On a motion made and seconded, the minutes from the June meeting were adopted without objection.

2014 Tax Expenditure Report

Demesia Padilla, secretary of taxation and revenue, and Frank Crociata, tax policy director, Taxation and Revenue Department (TRD), presented the department's 2014 Tax Expenditure Report. Secretary Padilla prefaced the presentation by introducing Mr. Crociata, the TRD's new tax policy director, and several of her staff who were in the audience. She noted that Mr. Crociata holds a law degree and has a background in state and local corporate, sales, excise,

property and income taxes and most recently worked for a large international firm in Phoenix. Secretary Padilla encouraged the committee to alert the department to any technical errors noticed in the report. She also noted that the 2015 report is due out in October or November.

Mr. Crociata explained that the presentation was divided into three parts: a comparison with previous years' reports; an overview of the 2014 report; and a summary of changes that the department wishes to implement for future reports.

Background. The 2014 report reflects a change in the TRD's understanding of what qualifies as a tax expenditure; this year, it used the federal definition of that term. Excluded are provisions that meet any of the following criteria: it is required by state or federal law; it relieves a taxpayer from paying one tax, but substitutes another; and it constitutes double taxation or tax pyramiding.

2014 report. The current report contains provisions in all of the state's major tax programs, except the property tax program. In all, the TRD identified 126 tax expenditures, 113 non-tax expenditures and 19 "marginal provisions", which are those that could fall under either of the first two categories.

For each provision, a series of characteristics, including its fiscal impact (i.e., the tax expenditure's cost to the state), the reliability of that fiscal impact information and the TRD's evaluation and recommendations, is considered. The provision's purpose is outlined if its purpose is explicit in its legislation or fiscal impact report. The TRD considered a provision's intended purpose and degree of utilization to evaluate its effectiveness. Under "recommendations", TRD statements include whether the provision should have a sunset and whether the provision needs clarity. Mr. Crociata stressed the need to weigh provisions' reliability factors, which are numbers from one to four or a "no data" designation. A "one" signifies that the provision requires separate reporting by taxpayers; thus, plenty of data support the TRD's findings. A "four", in contrast, signifies that there are little data from which the TRD could derive findings. There is a wide gulf in reliability between provisions marked two or higher and three or lower.

The report contains tax expenditure data broken down by broad categories: 1) citizen benefits; 2) economic development; 3) environment, conservation and renewable energy; 4) highly specialized industries; and 5) health care, a subset of the fourth category. Each expenditure is listed under only one category. The "citizen benefits" category consists of expenditures available to all taxpayers or that are designed to ease a population subset's tax burden. The cost of expenditures in the "citizen benefits" category constitutes 94.1% of the total, according to a chart in the report. Mr. Crociata cautioned that the conclusions illustrated by the chart are somewhat unreliable because of limitations inherent in producing it.

Future changes. The TRD intends to improve its future tax expenditure reporting by: 1) correcting technical inaccuracies, particularly in the index and statutory citation section; 2)

continually evaluating whether provisions constitute expenditures; 3) strengthening the quality of the data and the data retrieval system; 4) finding ways to improve data reliability; and 5) improving certain evaluation sections.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Tax expenditure sunsets. A member raised the question of whether tax expenditure expirations should be looked at as the discontinuance of a benefit to a particular group or as an opportunity for the legislature to review the benefit's effectiveness. Another member argued that: 1) every tax expenditure bill should include a sunset provision to institute a check on effectiveness and maintain awareness of the expenditure's existence and cost; and 2) the committee should make it a priority to routinely evaluate tax expenditures. Another member pointed out that the need for sunsets would be obsolete if a broad-base, low-rate tax reform policy — in which a drastic reduction in tax expenditures afforded the imposition of a drastically lower (primarily gross receipts tax (GRT)) rate — were enacted.

Broad-base, low-rate tax reform. A member discussed the impediments to adopting broad-base, low-rate tax reform: the lack of reliable information to guide policymakers in selecting a tax rate that would generate enough revenue to offset the cost of government expenses. Inaccuracy in quantifying expenditures with reliability ratings of three and below makes determining that rate especially difficult. The member stated that a system under such reform would offer the advantages of being fairer to taxpayers, i.e., not picking winners and losers, and reduce the incentive for tax evasion.

Accuracy of expenditures' cost estimations. Mr. Crociata reiterated that the error rate in reliability is high for an expenditure marked with a factor of three or four. The following reasons might contribute to a high error rate: absence of auditing; faulty code reporting by taxpayers; and faulty deduction amount reporting by taxpayers. Mr. Crociata said that the department has explored ways, but has not developed a specific plan, to get better data for determining tax expenditures' costs. A member requested that the TRD develop and propose to the committee recommendations for improving that system. Several members stressed the importance of accurately measuring expenditures' projected and actual costs — but expressed frustration with the historic difficulty in getting such accurate information. One member added that accurate information is especially important considering the volatility in the energy sector, which historically has provided the means to overcome underestimations in measures' projected costs.

Tax expenditure effectiveness. A member expressed a strong interest in receiving information that: 1) helps to determine tax expenditures' relative effectiveness; and 2) shows the consequences to nonrecipient taxpayers of benefits given to a different class of taxpayer.

Comparing New Mexico's Tax Structure to Other States: An Overview

Richard L. Anklaam, president and executive director, New Mexico Tax Research Institute, delivered a presentation on New Mexico's tax structure as it compares to that of other states. Mr. Anklaam prefaced his presentation by underscoring the limitations inherent in such a comparison: states have vastly different systems, making comparison difficult even with reliable, accurate information. He also reviewed the principles of good tax policy — adequacy, efficiency, equity, simplicity, comprehensiveness and accountability — which, he said, though they often compete with each other, are important to remember when evaluating proposed tax measures.

Sales taxes. The first modern American sales taxes originated in the 1930s and were generally imposed at low rates on the transaction of tangible personal property. Increasingly, sales taxes have been imposed on the transaction of services, too. Sales taxes are now common and take a variety of forms that vary in principle and in practice. For instance, the most commonly used sales tax, the "general retail sales tax", in principle is a single-stage levy on consumer expenditures applied at a final sale for use and consumption. Despite the tax's prevalence, no state that imposes it conforms to that principle. Instead, those taxes in practice capture some or many business-input, or intermediate, transactions.

In general, sales taxes feature the following attributes: 1) in contrast to income, franchise and property taxes, they are imposed on transactions involving tangible personal property and some services; 2) states administer sales taxes and distribute revenue from them to local governments, which lack the inherent power to tax; 3) states' sales tax bases match those of their local governments; 4) sales taxes are imposed on buyers, not sellers; 5) sales taxes imposed on sellers generally legally obligate the seller to remit and separately state the tax; 6) the economic incidence of sales taxes — regardless of their legal imposition — falls on the buyer; and 7) sales taxes are considered regressive, i.e., they impose a burden that proportionately increases, the lower a taxpayer's income.

Certain legal principles and practical considerations limit the application of sales taxes. For instance, an out-of-state seller must have some physical presence in a state for that state to tax it, and the object taxed cannot be subject to more than one state's sales tax. Concomitant with these limitations are issues of "e-commerce" fairness and issues in delineating who is the seller, who is the buyer and what is the transaction location. Moreover, the complexity of modern commerce introduces questions about what portion of a sale is taxable. For instance, how should a sale be taxed when a discount applies, and how should finance charges on a sale be treated?

Use taxes. Use taxes, also known as compensating taxes, are designed to equalize the disparity between taxes owed on in-state sales and taxes owed on out-of-state sales. Because they are meant to cancel the incentive for in-state buyers to pay less tax by making out-of-state purchases, use taxes generally are imposed on the same base and at the same rate as sales taxes. In practice, use taxes are difficult to enforce on individual and household buyers.

GRTs. In principle, GRTs are very broad-based excise taxes imposed on the total receipts of an enterprise. They generally feature few or no deviations, very low rates and a high degree of pyramiding. Some states impose sales taxes that resemble a GRT.

New Mexico's GRT. New Mexico's version of a sales tax, its GRT, is most aptly characterized as a broad-based, seller-imposed general retail sales tax. The tax's precursor was the emergency school tax enacted in 1933. The modern GRT provides deductions for sales for retail, credits for taxes paid to other states and many exemptions to delimit its otherwise broad application, which covers, among other things, intangible property and services. Like other states, New Mexico administers the GRT on behalf of its local governments, and it performs a similar function with respect to some tribes. Those arrangements make remittance easier for businesses. With its relatively high GRT rate, New Mexico relies more heavily for revenue on its GRT than most other states do. To overcome the constitutional prohibition against taxing the federal government, the state legally imposes its GRT on the seller. The state offsets GRT regressivity by offering a low-income comprehensive tax rebate.

New Mexico compared with other states. In 2011, as a percentage share of total tax revenues, New Mexico ranked among states: nineteenth for its property tax, thirty-ninth for its sales tax, eleventh for its excise tax, fifteenth for its personal income tax, third for its corporate income tax and thirteenth for its other taxes. Attributes of the state's economy somewhat influence its position in the rankings. Although New Mexico's state and local average tax rate falls in the middle on that scale among its neighbor states, its tax base is generally broader than those of its neighbors.

General caveats concerning data and rankings. Mr. Anklam drew the committee's attention to handouts showing state tax rankings and several dense publications aimed at comparing states' tax structures. Despite their bulk, he said, they provide only a cursory look at the world of state tax structures. He stressed that comparing states' tax structures involves great complexity and requires a thorough understanding of context. Using as a guide superficial comparisons of one state's tax structure to others, he said, can lead to bad tax policy.

Mr. Anklam praised the TRD's efforts to improve the quality and accuracy of its tax expenditure-related data and conclusions. He noted that accuracy in that context is elusive, partly because of flaws in taxpayer reporting.

Single Sales Factor Income Apportionment Option for Headquarters Operations

Mr. Anklam, Jason Espinoza, president, New Mexico Association of Commerce and Industry (ACI), and Suzanne Bruckner, past chair of the ACI's tax policy committee, reviewed the content of the provision in HB 2 (1st Special Session, 2015) relating to a corporate income tax single sales factor option for headquarters operations.

Corporate income tax apportionment. Mr. Anklam described the context of the enacted headquarters/single sales factor provision. Corporations operating in more than one state that

assess a corporate income tax use a state-specific apportionment formula to calculate how much tax is owed to each of those states. The formula is based in part on the degree to which a corporation is doing business in a state. It can include the factors of property, sales and payroll. In its purest form, apportionment is calculated by dividing, for each of those factors, a corporation's state-specific portion by its multistate aggregate. However, many states have deviated from that baseline to create economic development-driven tax incentives for corporations to locate to or stay in them. Specifically, many states have enacted formulas more favorable to corporations with high in-state payroll factors, property factors or both. States that have deviated from the baseline generally use formulas favorable to corporations whose in-state sales factors are low. In theory, these states reap the benefit of having within their borders corporations that concentrate their employees, infrastructure and equipment in the state and draw a high concentration of revenue from outside of the state.

Trends in changes to state apportionment formulas. Over time, the number of states with apportionment formulas that weigh the three factors equally has decreased. The number of states with formulas weighing the sales factor heavily — i.e., giving it double or triple weight in comparison with other factors, or weighing only the sales factor — has increased. Most states mandate the use of a particular formula, while some offer formula options.

New Mexico's single sales factor for headquarter operations. Mr. Espinoza reviewed the ACI's perspective on the benefits of extending a single sales factor apportionment formula option to corporations with headquarters operations in the state. He articulated that the new provision will: increase the state's attractiveness to corporations interested in relocating their headquarters; help draw in out-of-state revenue; and remove the disincentive for corporations based here to increase their capital and work force investments in New Mexico. Having in-state headquarters operations typically correlates to good jobs, spurs overall business growth and development and enriches the quality of life in a community.

Ms. Bruckner reviewed technical aspects of the new provision. Under it, a corporation can take advantage of the single sales factor option if it has its principal business activity in New Mexico and meets other facets of the definition of a "headquarters operation", including performing "centralized functions". While not a disqualifying factor, operating a call center alone does not satisfy the centralized-function requirement. Ms. Bruckner added that the new law also amended the "throwback" rule within the corporate income tax laws so as not to defeat the purpose of offering the use of a single sales factor formula.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Potential effects of the new policy. A member expressed concern at having the provision's benefit added to the corporate tax structure, considering the existing option of corporations to choose separate reporting and considering the possibility that corporations will exploit the measure under the potentially over-broad definition of "headquarters operation". Mr.

Anklam suggested that the TRD could by rule refine the law if unintended consequences result or if clarification is needed. Other members expressed skepticism about the prudence of the state's forfeiting revenue by adopting policies that lack evidence of effectiveness.

Members and presenters expressed diverging viewpoints on whether the measure would entice corporations like GAP and GE to establish their primary or regional headquarters in the state. Mr. Anklam opined that the measure would be most attractive to mid-size businesses, but would constitute a consideration less important to big businesses interested in relocating their headquarters. A member suggested that the measure might help satisfy a need for in-state jobs that the state's business school graduates can enter.

Accountability. Several members commented on the importance of continually evaluating the new provision for effectiveness. Mr. Espinoza said that the TRD would be able to track data useful to that evaluation and that the ACI was willing in the future to come before the committee to discuss the provision's effectiveness. Mr. Anklam noted that it would most likely take more than a year to properly understand the provision's effectiveness. A member requested from the TRD information on the effectiveness of the recently enacted single sales factor provision for manufacturing operations. Elisa Walker-Moran, chief economist, TRD, who was in the audience, said that the department is engaged in that analysis.

Reporting method and formula election. Mr. Anklam clarified that a corporation qualified under the new provision can make the single sales factor election regardless of its filing method (e.g., separate or combined with other entities within a unitary group) but that, once the election is made, a change to it requires the permission of the secretary of taxation and revenue. Ms. Walker-Moran agreed to look into the administrative requirements imposed on a corporation electing to use the single sales factor formula.

Fiscal impact. A member expressed some doubt that the projected fiscal impact of the measure was merely \$20,000. Mr. Anklam agreed that the estimation was most likely inaccurate but that a more accurate reflection of the provision's cost to the state would be noted in future tax expenditure reports. A member questioned the extent to which the benefit will cause an increase in corporate activity and the extent to which existing corporations that otherwise would have engaged in business, even without the benefit, will take advantage of it.

Adjournment

There being no further business before the committee, the RSTP adjourned at 12:15 p.m.